

THE WASHINGTON METRO AREA OFFICE MARKET: POSITIVE ABSORPTION, DESPITE JOB LOSSES, DUE TO THE IMPACT OF GOVERNMENT LEASING

How is it that the Washington metro area office market experienced positive net absorption in 2009 – despite a loss of 52,900 jobs?

The answer is a function of two key concepts: **the churning of jobs** and, more importantly, **heavy government leasing**.

The Churning of Jobs

Under the surface of the Washington employment picture is a critical phenomenon that has bolstered the regional office market throughout the most recent recession. The churning of jobs is occurring – in which higher-wage, office-using jobs are being created even as lower-wage, non-office-using jobs are being eliminated. For example, during the 12 months ending in February 2010, the most recent reporting period, the construction sector cut 17,600 jobs in the Washington metro area. At the same time, the Federal government sector gained 13,400 jobs. While the construction layoffs tend to be blue-collar workers, the new government jobs typically are office-using, higher-wage managerial positions, as the Obama administration staffs up to manage the financial services rescue program (bailout activities) and the stimulus package. Since February 2008, almost back to the start of the national recession, the Federal government has *created* 23,900 net new jobs in the Washington metro area.

During much of 2009, the Professional and Business Services sector was gaining jobs. It is a heavy user of office space. So, as with growth in

Federal government employment, job churn in 2009 among Professional and Business Services created office space demand.

Trends in Employment by Major Sector Washington Metro Area (In 000's of Payroll Jobs)			
	February 2010	12-Month Change	15-Year Annual Average
Fed. Govt.	366.5	13.4	0.7
Edu./Health	354.7	7.1	8.6
Leisure/Hosp.	245.0	-0.4	4.7
Retail Trade	247.4	-0.8	1.2
Transport/Util.	59.4	-1.5	-0.2
Other	181.7	-1.7	4.2
Whole. Trade	64.6	-2.0	0.3
Financial	145.2	-3.1	1.1
Manufacturing	52.7	-4.2	-0.8
Prof./Bus. Svs.	664.8	-5.7	18.9
Information	80.1	-5.9	0.0
St./Local Govt.	302.4	-11.8	5.0
Constr./Mining	133.3	-17.6	2.3
Total	2897.8	-34.2	46.0

Source: BLS, Delta Associates; April 2010.

So, even without overall job gains, there has been demand for office space, thanks to job churn.

Heavy Government Leasing

The General Services Administration (GSA) and various Federal agencies have been very active over the past year at leasing office space due to several factors:

1. Space consolidations (often with expansions).
2. Renewals (often with expansions in place).
3. Taking advantage of reduced rental rates in today's softer market to upgrade space.
4. "Swing space" to accommodate GSA's \$5.5 billion stimulus-sponsored renovation of its stock.
5. Expansion of the Federal government's 45 million SF leased office space inventory in the capital region to accommodate an expanding Federal workforce.

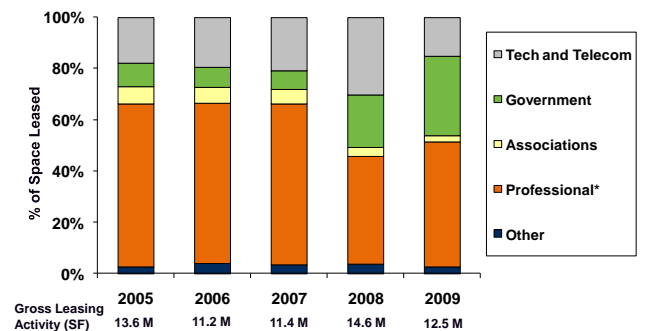
These further explain how net absorption, which we tally when space is leased, can be ahead of employment growth metro-wide.

Altogether, looking at gross leasing activity by year, we can see how active the government has become since the start of 2009. In each substate area, the share of leasing attributable to the public sector (including state and local governments, but mostly due to Federal activity) rose from 2008 to 2009.

In the Washington metro area as a whole, government leasing activity increased to 26% of all SF leased during 2009, compared to 14% during 2008, and 10% in 2007.

In **Northern Virginia**, government leasing activity increased to 31% of all SF leased during 2009, compared to 21% during 2008, and 7% in 2007. The favored submarket was Crystal City/Pentagon City. Notable deals included the Drug Enforcement Administration's renewal of 504,000 SF at 600-700 Army-Navy Drive in Crystal City/Pentagon City. In addition, the GSA inked roughly 300,000 SF for several new spaces along Crystal Drive.

Office Leasing Activity by Sector
Northern Virginia
2005 – 2009

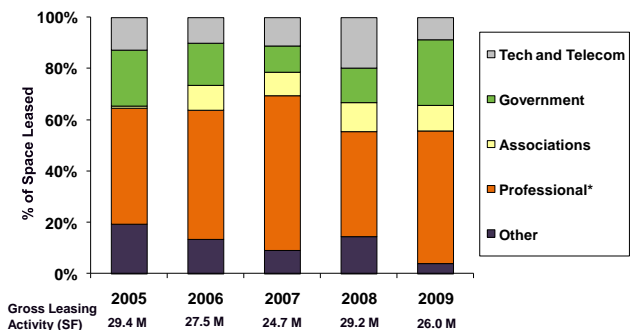


Source: CoStar, Delta Associates; April 2010.

*Legal, Financial, Business Services

In **Suburban Maryland**, government leasing activity increased to 14% of all SF leased during 2009, compared to 3% during 2008, and 8% during 2007. Renewals by the government drove activity, including the Department of Health and Human Services' renewal of 802,000 SF at 5600 Fishers Lane in Rockville.

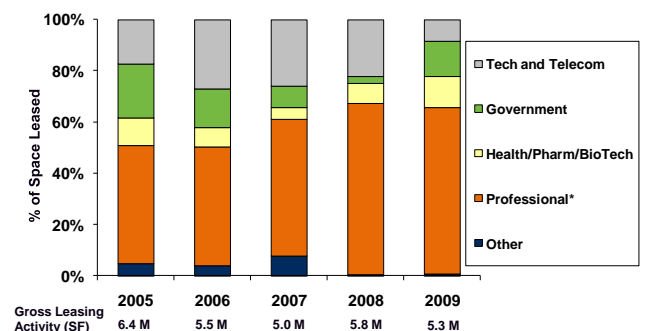
Office Leasing Activity by Sector
Washington Metro Area
2005 – 2009



Source: CoStar, Delta Associates; April 2010.

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Office Leasing Activity by Sector
Suburban Maryland
2005 – 2009



Source: CoStar, Delta Associates; April 2010.

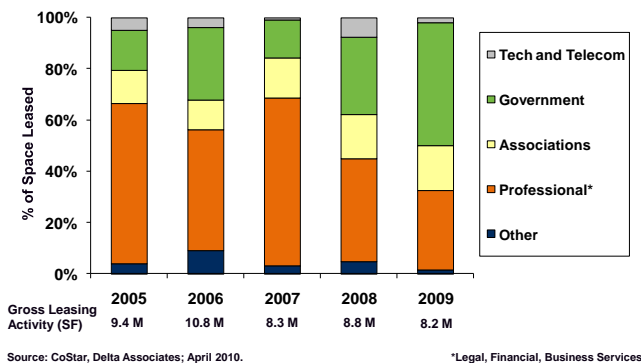
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In the **District of Columbia**, government leasing activity increased to 48% of all SF leased during 2009, compared to 30% during 2008, and 15% in 2007. The favored submarket was NoMa, where the IRS leased 167,000 SF at 77 K Street, NE and GSA leased 329,000 SF at 1275 First Street, NE. This GSA deal was for swing space as it renovates its own headquarters into a more environmentally-friendly facility.

In December 2008, we offered our initial assessment of then-pending increased spending by a larger Federal establishment on office leasing in the Washington region. We estimated at that time that 2 to 4 million SF of *net absorption* would result from these activities over a 2- to 3-year period (2009-11). We now believe it may be slightly more, at 2.5 to 4.5 million SF. An impact of three million SF (one million SF per year over three years) would be material, given the long-term average net absorption for this market of 7.5 million SF annually. This estimate of new demand combines programs administered by the Federal Reserve, the FDIC, the Treasury Department, the Federal Housing Administration, and other proposed activities.

In addition, the GSA has only spent \$2 billion to date (36%) of the \$5.5 billion it was appropriated under the American Recovery and Reinvestment Act (the stimulus package) to upgrade and “green” its buildings. We expect the agency to remain very active throughout the balance of 2010, generating demand for “swing space,” especially in the capital region.

Office Leasing Activity by Sector
District of Columbia
2005 – 2009



Source: CoStar, Delta Associates; April 2010.

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Delta Associates

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